

16 March 2009

Hon. Gerry Brownlee  
Minister of Energy and Resources  
Parliament Buildings  
WELLINGTON

Dear Minister

**Electricity Commission's submission on proposed amendments to the Government Policy Statement**

Thank you for the opportunity to comment on proposed amendments to the Government Policy Statement on Electricity Governance.

I enclose the Commission's submission, which includes an executive summary covering all the key points of the submission.

The Commission strongly supports the Government's objective of ensuring the grid planning, regulatory review and approval process supports the reliability of the transmission grid. However, it has concerns about the level of specificity of the proposed amendments. Such specific requirements are likely to present difficulties for the Commission and the Minister when they are required to consider the necessary changes to the Electricity Governance Rules.

Instead, the Commission suggests an alternative amendment designed to meet the Government's objective without creating such a difficulty.

I am, of course, available to discuss any aspect of the Commission's submission, if you wish.

Yours sincerely



David Caygill  
**Chair**

**SUBMISSION OF THE ELECTRICITY COMMISSION ON PROPOSED  
AMENDMENTS TO GOVERNMENT POLICY STATEMENT**

**March 2009**

## EXECUTIVE SUMMARY

1. The Commission appreciates the opportunity to comment on proposed amendments to the Government Policy Statement on Electricity Governance (**GPS**), notified to it by the Minister of Energy and Resources on 3 March 2009.
2. The Commission's submission relates principally to paragraphs 87 and 88 in the proposed GPS. The intent of those paragraphs is that the Commission should not be required to assess and evaluate the merits of proposed investments that are valued at less than \$20 million.

### **Are there issues with grid reliability and can the proposed GPS address them?**

3. The Commission shares the Government's wish to ensure security of supply, of which grid reliability is an essential component. It is timely for the Government to seek assurance that the processes in place to address grid reliability, including the regulatory review and approval process, are making the best possible contribution towards reliability.
4. The Commission is aware of issues that may be perceived as affecting grid reliability. This submission comments on those issues in order to provide an analysis of the effect the proposed amendments are likely to have on grid reliability.

#### *Recent outages*

5. First, recent major outage events have given rise to considerable public concern about the reliability of the grid. Analysis of the recent outages shows that, in every case, they arose from the maintenance of the relevant assets. The Commission is not responsible for authorising Transpower's expenditure on maintenance of the assets comprising the grid. The proposed amendment will therefore not address any concerns the Government may have in relation to the recent outages.

#### *Regulatory review and approval process*

6. The second issue relates to whether the regulatory review and approval process is delaying or will delay timely investment in the grid, affecting grid reliability. In particular, delays might be caused by the Commission taking an excessive amount of time to deal with applications or by the application requirements imposed on Transpower being too onerous.
7. The Commission submits that, notwithstanding some initial issues, it has been able to process Transpower's applications in a reasonably timely way. At this time the only applications currently before the Commission are the North Auckland and Northland Upgrade, which is in its final stages of consideration, and two minor grid investment proposals submitted on 12 March 2009.
8. The Commission, however, does believe there is further scope for improving and streamlining the grid planning, regulatory review and approval process. The

Commission believes there is opportunity for a greater level of engagement between Transpower and the Commission prior to Transpower making an application, to ensure that no more resources are applied to the preparation of applications than is required for Transpower and the Commission to undertake their respective roles and make robust decisions. The Commission considers that considerable progress has already been made in improving the process in this respect.

*Appropriate to review the regulatory review and approval process*

9. The Commission would be supportive of there being a requirement on it in the GPS to undertake a review of the regulatory review and approval process to make it more efficient where possible, while still providing robust scrutiny as appropriate to the value of the proposed investment.

*Some steps already taken to streamline regulatory review and approval process*

10. The Commission places considerable emphasis on provisions in the Electricity Governance Rules requiring it to have regard to the regulatory costs imposed on Transpower, and requiring that the level of analysis applied to an investment proposal be commensurate with the value of the proposed investment.
11. Steps have already been taken by Transpower and the Commission to streamline the regulatory review and approval process.
12. In particular, Transpower and the Commission have worked together to develop and establish the Grid Upgrade Investment and Review Policy (**GUIRP**), which has been in place since June 2008. The GUIRP seeks to better integrate Transpower's and the Commission's processes, enabling them to co-operate more effectively and make the regulatory review and approval process more efficient.
13. Since the establishment of the GUIRP, Transpower has also put forward a proposal seeking a number of changes to part F of the Electricity Governance Rules. Significantly, one of Transpower's proposals is to introduce a streamlined approval process for investments below a certain threshold. The Commission has resolved to consider Transpower's proposals expeditiously, but further work needs to be done on the proposals before the Commission can consult on them.

**Commission's concerns about the proposed GPS**

14. The Commission supports the general objective expressed in paragraph 87 of the proposed GPS (subject to removing the reference to maintenance in paragraph 87). It is, however, concerned about the specific requirements set out in paragraph 88 of the proposed GPS.
15. The Commission submits that the specificity of the proposed paragraph 88 may present difficulties for the Commission and the Minister when they are required to consider the necessary changes to the Electricity Governance Rules.

### *Need to change Electricity Governance Rules*

16. If the GPS is amended as proposed, in order to seek to give effect to the GPS, the Commission would need to consider amending the rules to provide for the detail set out in paragraph 88.

### *Issues with paragraph 88*

17. The Commission believes that the specific requirements set out in paragraph 88 of the proposed GPS are likely to present difficulties during the rule change process. This is because the analysis required by the Electricity Act 1992 may not support rules that accord with the very specific requirements in paragraph 88.
18. The Commission has identified some issues that are likely to affect the cost/benefit analysis of a rule change proposal and the analysis of the extent to which the objective of the proposal would be promoted or achieved by the rule change. Some possible issues are:
  - increasing the likelihood of litigation;
  - jeopardising effective scrutiny of larger investment proposals;
  - increasing the costs associated with reduction in scrutiny of investment proposals; and
  - increasing the impact of reduced scrutiny because of the aggregate value of smaller investments.

### **Commission's recommendations**

19. The Commission, therefore, submits that the Government should consider setting the proposed amendments in the GPS at a higher level, directed at the objective to be pursued, rather than the means by which it should be pursued. This would avoid the problems caused by the specificity in paragraph 88 of the proposed GPS.
20. The Commission's particular recommendations on paragraphs 87 and 88 are:
  - proposed paragraph 87 should be amended by omitting the word "maintenance" as grid maintenance expenditure is authorised by the Commerce Commission and not the Electricity Commission; and
  - proposed paragraph 88 should be amended to provide as follows:

*The Government expects the Commission to review section III of part F of the Electricity Governance Rules and its own procedures to meet the objective expressed in paragraph 87, and to report to the Minister by 31 July 2009 on whether it recommends any changes be made to the rules and/or its procedures.*

## **Commission supports removal of unnecessary detail from GPS**

21. The Commission makes a general comment that it supports the removal from the GPS of any matters providing unnecessary detail. For example, the Commission supports the proposal to remove paragraph 7 from the GPS, which requires the Commission to make extensive use of advisory groups. Although the Commission considers there is value in using advisory groups, it believes that such detail is not appropriate in the GPS.

## **A. INTRODUCTION**

22. The Commission appreciates the opportunity to comment on proposed amendments to the Government Policy Statement on Electricity Governance (**GPS**), notified to it by the Minister of Energy and Resources on 3 March 2009.

### **A.1 Importance of grid reliability**

23. The Commission shares the Government's wish to ensure security of supply, of which grid reliability is an essential component. The electricity system must be secure and reliable and it must deliver energy to consumers at a reasonable price. This is vitally important for individual consumers, and for the economy as a whole.
24. The Commission acknowledges that it is important that the Government be satisfied about grid reliability, and that the regulatory review and approval process contributes to that.

### **A.2 Focus of submission**

25. This submission relates principally to the proposal to insert new paragraphs 87 and 88 into the GPS under the heading "Investment in minor transmission works". The intent of that proposal is that the Commission should not be required to assess and evaluate the merits of proposed investments that are valued at less than \$20 million. This submission also briefly comments on the desirability of removing unnecessary detail from the GPS.

### **A.3 Outline of submission**

26. Part B of this submission provides some background information about the regulatory review and approval process and the performance of the grid.
27. Part C examines two issues that may be perceived as affecting grid reliability, and analyses whether they can be addressed through the GPS. The two issues are recent major outage events, and whether the regulatory review and approval process is creating delays in timely investment in the grid. That part concludes that it is timely for the Government to seek assurance that the regulatory review and approval process is supporting grid reliability, and that the proposed GPS could be used to assist the Commission to pursue further efficiencies in the process.
28. Part D outlines the steps that have already been taken to begin addressing concerns about efficiencies in the regulatory review and approval process. It discusses provisions in the Electricity Governance Rules, the work that Transpower and the Commission have already undertaken to streamline processes, and the Commission's response to Transpower's proposed changes to the rules.
29. Part E explains the Commission's concerns about the specificity of matters covered in paragraph 88 of the proposed GPS. The Commission is concerned

that such specificity may cause difficulties for the Commission and the Minister when they are required to consider the necessary changes to the Electricity Governance Rules resulting from the proposed GPS.

30. Part F sets out the Commission's recommendation on the proposed GPS amendments. The Commission submits that the Government should consider setting the proposed amendments at a higher level, directed at the objective to be pursued rather than the means by which it should be pursued. This would avoid problems caused by the specificity of paragraph 88 of the proposed GPS.
31. Part G provides some general comments on the removal of unnecessary detail from the GPS.

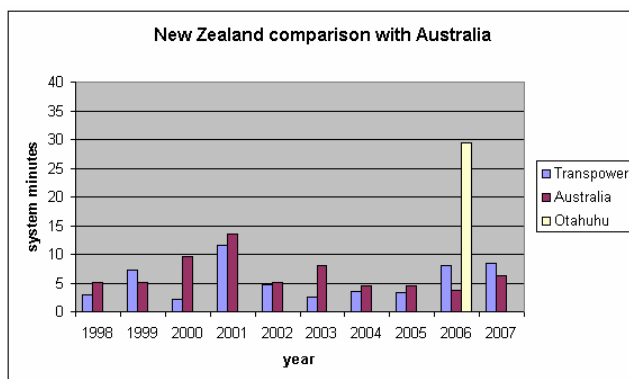
## B. BACKGROUND

### B.1 Rationale for regulatory review and approval process

32. Prior to the establishment of the Commission, investment in the grid was hindered because Transpower and industry participants had become ‘deadlocked’ over the need for investment and how the costs should be allocated. Transpower’s chief executive has recently commented that part of the reason for the underspending on the grid in the 1990s through to 2003 was that Transpower “had trouble getting its bills paid”.
33. A principal rationale for establishing the Commission’s regulatory review and approval process was to:
- (a) address the absence of incentives on the grid owner, as a natural monopoly, to make appropriate investment decisions, including considering alternatives to augmenting its own asset base, such as demand side management or investment in generation closer to the load when those options may be cheaper; and
  - (b) provide a discipline on the planning process so that errors that otherwise may go undetected are corrected before they impose undue costs on consumers of electricity.
34. The regulatory review and approval process also provides certainty to Transpower of the recovery of its costs of investments, addressing a major cause of under-investment before the current regulatory regime was established.

### B.2 Performance of the grid

35. In considering what may be necessary to ensure reliability of the grid, it is important to be aware of the current state of the grid in terms of reliability.
36. As the following graph shows, the reliability of New Zealand’s transmission grid (as measured by system minutes of outages) has not historically been much different from the reliability experienced by Australian transmission companies (when the Otahuhu substation incident in 2006 is excluded).



Sources: *Transpower’s Quality and Performance Report & Energy in Australia 2008* by the Australian Bureau of Agricultural and Resource Economics (ABARE)

## **C. DEFINING THE PROBLEM**

37. The Commission acknowledges the need to ensure the reliability of the grid, given its significant contribution to security of supply.
38. The Commission is aware of issues that may be perceived as affecting grid reliability. The purpose of this section is to examine those issues to determine whether they can be addressed through the GPS, and, if so, how that might best be done.
39. Recent major outage events are one of the issues that the Commission is aware of. These events have given rise to considerable public concern about the reliability of the grid.
40. Another issue is whether the regulatory review and approval process is creating or will create delays in timely investment in the grid, affecting its reliability. In particular, delays might be caused by the Commission taking an excessive amount of time to deal with applications or by the application requirements imposed on Transpower being too onerous.

### **C.1 Factors contributing to grid reliability**

41. Because the Commission's role is to review proposals for grid investments, grid reliability primarily depends on Transpower's planning processes.
42. In that context, the reliability of the grid depends on three processes:
  - (a) maintenance of the assets comprising the grid (the expenditure for which is approved by the Commerce Commission or agreed between Transpower and a customer);
  - (b) the undertaking of replacement and refurbishment (small capital items) (approved by the Commerce Commission); and
  - (c) the building of new grid assets so that they are commissioned and available when they are needed (subject to the approval of the Electricity Commission).
43. The reliability of the grid will obviously be affected by failures in any of these processes. It follows that an intervention to address a perceived grid reliability problem can be effective only if it targets the process that is giving rise to the problem.
44. While some grid assets may be included in a grid upgrade plan for approval by the Commission, a substantial number of new grid assets will be connection assets that are funded and built under bilateral agreements between Transpower and the relevant customers (for example, Vector, Meridian, or Contact) and the level of supply security for those customers is based on that agreement. Such assets are not submitted for approval to the Commission.

45. In assessing what further interventions are required in relation to the timely building of new assets, it is important to understand the current framework under which Transpower plans its investment programme, consults with its customers in relation to that programme, and obtains regulatory approvals to allow it to invest in the grid and recover its costs from its customers.
46. Because transmission grid assets are long-term assets that have long lead times for their planning, construction and commissioning, Transpower's planning processes must also have long lead times. Also, grid assets tend to be high value (usually in the tens of millions of dollars), so that the business justification for them to be approved and financed requires sound technical analysis and economic justification. This applies to Transpower in exactly the same way as it would to any commercial entity proposing to invest in assets of a similar value.
47. The result is that, if Transpower's internal forward planning processes for approving and financing new assets are working adequately, there is no reason why the Commission's review and approval processes should cause any delay. This is because, provided the reports and analysis required to satisfy Transpower's Board that investments are necessary and adequate, the information contained in them will be sufficient for the Commission to undertake its analysis. This is especially the case for smaller investments, and for bundles of smaller investments.
48. Key aspects of the current framework are as follows:
  - Transpower publishes an Annual Planning Report (**APR**), which includes the grid reliability report, and the grid economic investment report. Transpower has been publishing the APR since 2006;
  - The publication of the APR is anticipated by the grid upgrade and investment review policy (discussed below). The APR is intended to supplement the grid reliability report and grid economic investment report by providing a detailed, comprehensive and forward-looking plan. The APR also includes a projects calendar, which includes "all projects that Transpower considers likely to be investigated and developed into investment proposals over the next five years".
  - Transpower is required by rule 12A of section III of part F of the Electricity Governance Rules to publish a grid reliability report. The grid reliability report must include an assessment of whether the power system can be reasonably expected to meet an *N-1* standard generally, and in particular whether the power system would be resilient to specified events, and would be able to provide a sufficient supply of electricity to satisfy demand. The grid reliability report must include planning proposals for addressing any issues identified.
  - Transpower is required by rule 6.2 of section VI of part F of the rules to publish a grid economic investment report.

- Transpower and the Commission have worked together to develop the Grid Upgrade and Investment Review Policy (**GUIRP**), which is intended to facilitate the efficient development of technically, economically, environmentally, and commercially practical investment proposals that meet the need for investment and the requirements of the rules. The GUIRP also provides for bundling of small (less than \$10 million) and medium-sized (\$10-100 million) investments to enable a streamlined process for such investments. An objective of the GUIRP is to more closely integrate Transpower's business planning processes with the regulatory review and approval process.
- Finally, the Commission is engaging with Transpower to develop a policy that facilitates the approval of multi-year expenditure on replacement and refurbishment of elements of the grid. This policy is anticipated by Transpower's settlement agreement with the Commerce Commission (replacement and refurbishment expenditure is currently approved by the Commerce Commission).

49. The effect of these processes, especially the APR and the grid reliability report, is that investment projects are able to be identified well in advance of the need date of the relevant investments. This results in opportunities for investments to be bundled so that they can be considered most efficiently by Transpower's Board and by the Commission, and to bring them forward for consideration so that approval processes do not delay investments or unduly divert resources.

## C.2 Recent outages

50. One area of considerable public concern in relation to the reliability of the grid has been that, notwithstanding the historical generally satisfactory performance of the grid described above, there have been significant recent outage events that have caused significant disruptions to supply:

Year	Year SM*	Major Outage Event	Event SM	% of year SM
2009	7.6	Penrose 110/33kV transformer failure	4.5	59%
		Manukau conductor break	0	
2008	24.6	Wilton transformer	0.17	58%
		Kawerau 11 kV bus outage	14.1	
2007	8.3	West Coast loss of supply	3.9	69%
		Upper South Island	1.8	
2006	37.5	Otahuhu substation outage	29.4	78%

Source: Transpower presentation, Annual Reports and Quality Performance Report 07/08

\*SM is system minutes, a comparative measure of network reliability between different grid owners

51. The outage events listed in the table above are a major component of the total system minutes of transmission-related outages in the relevant years. Therefore, in order to effectively address concerns about the overall reliability of the grid, it is important to understand the causes of those events.
52. The outages referred to in the table above had the following causes:
- (a) *Penrose transformer* — a transformer failed while operating at *N* security during maintenance. This level of security was agreed between Transpower and Vector. This is a customer (Vector)-funded connection asset and therefore is not subject to the Commission's investment review and approval process.
  - (b) *Manukau (Flat Bush) conductor break (line conductor collapse)* — the line was recently upgraded but a conductor joint failed. The full details of this are not known to the Commission. However, the Dupont report (September 2008) commissioned by Transpower identified that Transpower was not adequately inspecting line joints. This is not subject to the Commission's investment review and approval process.
  - (c) *Wilton transformer* — maintenance problems and a dispute with Vector caused extended periods of *N* security operation of a customer-funded transformer, which blacked out much of the Wellington CBD. A protection failure occurred during maintenance. This is a customer (Vector)-funded connection asset and therefore is not subject to the Commission's investment review and approval process.
  - (d) *Kawerau 11 kV bus* — two 11 kV supply busses were removed from service to investigate a bus noise, eventually found to be caused by a faulty current transformer. These are customer (Norske Skog)-funded connection assets and therefore are not subject to the Commission's investment review and approval process.
  - (e) *Upper South Island* — earth sticks left on the Islington 220 kV bus in error during maintenance caused a 220 kV bus fault and supply interruptions to the upper South Island. This is not subject to the Commission's investment review and approval process.
  - (f) *West Coast* — part of the Westport 11 kV supply bus exploded following a lightning strike. This is a customer (Buller Electricity)-funded connection asset and therefore is not subject to the Electricity Commission's investment review and approval process.
  - (g) *Otahuhu substation* — a shackle failed due to minor design/maintenance issues and caused widespread loss of supply to Auckland. This is not subject to the Commission's investment review and approval process.

53. All of the above events have been largely attributable to a need for better maintenance of the relevant assets.
54. The Commission acknowledges that the causes of the outages are widely misunderstood, and that this has led to a perception that they relate to delays in upgrades. However, at the time of the outages, there were no relevant proposals in front of the Commission that related to, or anticipated, such failures.
55. The Commission is considering improving its monitoring of grid reliability so that the causes of problems, and therefore the best means of addressing them, can be better understood.

*Issues with maintenance being addressed*

56. The Commission understands that Transpower has under-spent the capital expenditure budget approved by the Commerce Commission for refurbishment and replacement (usually for small reliability investments) for the 2008/09 year. This may be due to delays in implementing investments. However, this under-spending would be a repeat of the 2007/08 year where it under-spent by approximately \$40 million.
57. The Commission is not aware whether Transpower has spent its budgeted maintenance costs. This makes it difficult to determine whether that budget is sufficient to ensure more optimal grid reliability.
58. However, those costs are not subject to the Electricity Commission's investment review and approval process.
59. If Transpower does not have a sufficient operation and maintenance budget to achieve reduction of the events such as those that have given rise to the Government's concern, it may be desirable to increase the cap on maintenance spending under the Commerce Commission threshold. This is a matter for the Commerce Commission and Transpower to consider, and does not relate to the Electricity Commission's functions.

*Proposed GPS will not address maintenance issues*

60. As the Commission is not responsible for overseeing Transpower's expenditure on maintenance of the assets comprising the grid, it is obviously not possible to address any concerns the Government may have in regard to the recent outages by amending the GPS.

### **C.3 Regulatory review and approval process**

61. The area that obviously can be affected by amending the GPS is the Commission's regulatory review and approval process. The Commission agrees that the Government is entitled to seek assurance that the processes in place to address reliability, including in this case the regulatory review and approval process, are making the best possible contribution towards grid reliability.

*Applications being dealt with in a timely way*

62. Concerns about the regulatory review and approval process appear to focus on whether delays from the process affect timely investment. Delays could, for example, be caused by the Commission taking overly long to process applications, or by unnecessarily onerous requirements being imposed on Transpower.
63. The transmission grid has suffered for decades from limited investment. Under the procedures for regulatory review and approval established in the Electricity Governance Rules in 2005, Transpower and the Commission have been able to implement quickly processes to bring forward significant levels of investment in the grid.
64. Since 2005, the Commission has approved \$2.103 billion of investments. The Commission considers that its consideration of investment proposals has resulted in significant constructive changes to investments that have benefited both reliability and the cost of electricity.
65. Understandably, these approval processes have involved a period of learning for both Transpower and the Commission, and the experience has not been without “teething” issues for all parties.
66. However, the Commission has been pleased that, with a high level of commitment shown by personnel of Transpower and the Commission, the process has developed substantially since its inception, and there have been good examples of co-operative solving of implementation issues, while both organisations have maintained the integrity of their roles.
67. Where proposals have been complete, and the justification for an investment is made clear in an application to the Commission, the Commission has been able to approve the relevant investment quickly, for example:
  - (a) *Wairakei Ring Investment Proposal*—On 17 December 2008, Transpower submitted the Wairakei Ring proposal which sought approval to spend up to \$141 million. On 20 February 2009, the Commission published a notice of intention to approve the proposal.
  - (b) *Maungatapere Bus Security Investment Proposal*—On 19 December 2008, Transpower submitted a proposal which sought approval to spend up to \$4.1 million. On 20 February 2009, the Commission published a notice of intention to approve the proposal.
  - (c) *Wilton 110kV Interconnection Investment Proposal*—On 19 December 2008, Transpower submitted the Wilton proposal which sought approval to spend up to \$9.57 million. On 13 March 2009, the Commission published a notice of intention to approve the proposal.
  - (d) *Woodville-Mangamaire-Masterton Transmission Investment Proposal*—On 19 December 2008, Transpower submitted a proposal which sought approval

of up to \$17.4 million. On 13 March 2009, the Commission published a notice of intention to approve the proposal.

68. Planning and investment in transmission assets involves long lead times. In recognition of this, the Commission has, in every instance when Transpower has requested it, approved funds for preliminary planning and analysis for major proposals, as follows:
- (a) *HVDC upgrade project*—In September 2005, Transpower applied to the Commission for approval of up to \$6.3 million for prudent expenditure on preparatory work for the HVDC upgrade project. The need for the preparatory expenditure was to preserve the proposed delivery date, and undertake some technical design and environmental analysis including surveys of the cable route. The Commission approved the expenditure in early December 2005.
  - (b) *Auckland CBD cable ducts (Stage 1)*—In November 2005, Transpower sought approval for up to \$7.81 million for prudent expenditure on preparatory work for a project to install two 220kV cables between Penrose and Albany substations in Auckland to reinforce transmission capacity in the region. The Commission approved the expenditure in late December 2005.
  - (c) *Auckland CBD cable ducts (Stage 2)*—On 22 May 2006, Transpower sought approval for up to \$16.5 million for further prudent expenditure on preparatory work for a project to install two 220kV cables between Penrose and Albany substations in Auckland to reinforce transmission capacity in the region. The Commission approved up to \$9.38 million of the proposed expenditure in October 2006.
  - (d) *Demand-side participation*—In May 2007, Transpower sought approval of up to \$8.27 million for a trial to test demand-side participation and related contractual issues in the upper South Island as a potential alternative to a grid upgrade in the upper South Island (and the wider application of such contractual demand-side participation in grid investment). The Commission approved the amount in late June 2007.
69. These approvals reflect the Commission's concern that critical paths and timelines are maintained, and gave Transpower the ability to hire additional resources to undertake development of grid investment proposals, speeding up the investment process.
70. While the Electricity Governance Rules provide that the Commission may consult on such applications for expenditure, the Commission approved the expenditure proposed in the first two applications without consulting third parties. Timely consultation was carried out for the remaining two applications.
71. In addition, the Commission has accepted and approved applications that involve the bundling of projects. In 2005, Transpower submitted 30 "tactical transmission

upgrades” for approval under the interim grid expenditure provisions and eleven “grid development proposals”. The analysis and decision-making on that bundle of proposed upgrades was carried out simultaneously.

72. The Commission has also been able to expedite investments by giving Transpower an early indication, even including prior to receiving an investment proposal from Transpower, that the Commission will consider particular spending favourably. This has allowed Transpower to order equipment at an early stage, and so ensure that investments can be implemented quickly. Examples of this “letter of comfort” approach include in relation to land purchased for the Huntly East switching station in 2006, and the urgent 220/110kV interconnecting transformer at the Penrose substation in 2009.
73. The Commission is satisfied that overall, notwithstanding some initial issues, it has been able to process Transpower’s applications in a reasonably timely way. The only applications currently before the Commission are for the North Auckland and Northland upgrade, which is in its final stages of consideration, and two minor proposals that were submitted on 12 March 2009.

#### *Requirements imposed on Transpower*

74. The remaining issue to consider is whether the application requirements imposed on Transpower are too onerous. It would of course be a concern if requirements imposed on Transpower by the Commission on the documentation of applications were delaying the consideration of investments.
75. The Commission does not believe that that is the case. However, the Commission does believe there is further scope for improving and streamlining the regulatory review and approval process.
76. The Commission is aware of statements by Transpower that the obligations currently imposed on it are sometimes quite onerous.
77. The Commission itself has been concerned on occasion that more information than is necessary has been provided by Transpower in relation to some applications. It also believes there is opportunity for a greater level of engagement between Transpower and the Commission prior to Transpower making an application, to ensure that no more resources are applied to the preparation of applications than is required for Transpower and the Commission to undertake their respective roles and make robust decisions.
78. The Commission is committed to continuing to work with Transpower to improve investment proposals so that they better justify the expenditure they cover, and better meet the needs of Transpower itself, regulators who oversee Transpower’s spending, and industry participants and consumers who meet the costs of the expenditure.

79. The Commission considers it is timely for the Government to seek assurance that the regulatory review and approval process is supporting grid reliability. The Commission would therefore be supportive of there being a requirement on it in the GPS to undertake a review of the regulatory review and approval process to make it more efficient where possible, while still providing robust scrutiny appropriate to the value of each investment.

## **D. STEPS TAKEN TO ADDRESS THE PERCEIVED PROBLEM**

### **D.1 Principles in Electricity Governance Rules consistent with streamlining processes**

80. The Commission is mindful and supportive of the requirement in the Electricity Governance Rules that, when making any decisions during the regulatory review and approval process, it must have regard to the regulatory costs imposed on Transpower and whether these may exceed the benefits to end use customers (rules 12.1.3 and 13.3.1 in section III of part F of the rules).
81. This general requirement is supported by a particular requirement in clause 12 of the grid investment test, which provides that the level of analysis that is applied to investment proposals should be commensurate with the value of the relevant investment.
82. The Commission considers that those requirements are important safeguards to ensure that the costs of the regulatory process do not outweigh the benefits it confers. The Commission takes these requirements seriously. It is important that the process be no more onerous on Transpower than it needs to be to ensure prudent investment in the grid.

### **D.2 Transpower and the Commission working together to streamline process**

83. Transpower and the Commission have together developed and established the Grid Upgrade and Investment Review Policy (**GUIRP**). It has been in place since June 2008.
84. The purpose of the GUIRP is to promote an effective process for:
  - (a) the preparation of investment proposals by Transpower, as part of Transpower's wider grid planning process; and
  - (b) the review and approval of those proposals by the Commission.
85. The GUIRP provides a framework for the way the Commission and Transpower will interact during the grid planning, review and approval process, and provides guidance to interested parties in relation to how Transpower and the Commission will interact with them. Essentially, it seeks to better integrate Transpower's and the Commission's processes and enables them to co-operate effectively in making the regulatory review and approval process more efficient. For example, the regulatory review and approval process is co-ordinated with Transpower's planning cycle, both in terms of timing and requirements.
86. The Commission expects that the GUIRP will facilitate further bundling of investments, so as to improve the efficiency of the regulatory review and approval process.
87. In relation to more recent investment proposals, the Commission has appreciated the level of engagement by Transpower staff, and the Commission considers that

the Transpower staff with whom the Commission staff interface most often are committed to engaging with the Commission (as are the Commission staff committed to engaging with Transpower staff). The Commission welcomes this level of engagement and considers that Transpower and the Commission have made considerable progress in making the regulatory review and approval process more streamlined and integrated with Transpower's business planning processes.

### **D.3 Transpower's proposed changes to the Electricity Governance Rules**

88. Late last year, Transpower put forward a proposal seeking a number of changes to part F of the Electricity Governance Rules to the Commission. Those proposed changes are relevant to the Government's proposed GPS as one of Transpower's proposals is to introduce a streamlined approval process for investments below a certain threshold.
89. In February this year, the Commission's board considered Transpower's proposals and resolved to consider them expeditiously. Significant further work needs to be done before the Commission can begin consultation on the proposals. At this stage, the Commission is seeking further information from Transpower on its proposals.

## **E. PROPOSED GPS MAY NOT RESULT IN GIVING GOVERNMENT ASSURANCE OF RELIABILITY**

90. The Commission considers that the concern underlying the proposed amendments to the GPS is that the Government wants assurance that the regulatory review and approval process is not unduly complex so as to jeopardise timely investment in the grid, ensuring the reliability of the grid.
91. The Commission submits that the specificity of the proposed paragraph 88 of the GPS may present difficulties for the Commission and the Minister when they are required to consider the necessary changes to the Electricity Governance Rules.

### **E.1 Proposed GPS would require consideration of changes to the Electricity Governance Rules**

92. If the GPS is amended as proposed, in order to seek to give effect to the GPS, the Commission would need to consider amending the rules to provide for the detail set out in paragraph 88 of the proposed GPS.

### **E.2 Process for amending the Electricity Governance Rules**

93. Sections 172E and 172F of the Electricity Act prescribe the process that must be followed to amend the Electricity Governance Rules. In summary:
- the Minister may make a rule change only if the change implements the effect of a recommendation of the Commission;
  - the Commission may recommend a rule change only if it has sought to identify all reasonably practicable options for achieving the objective of the rule;
  - the Commission must assess the options by considering the costs and benefits of such options, and the extent to which the objective would be promoted or achieved by each option; and
  - the Commission must carry out consultation on a statement of proposal for the proposed rule change.
94. These requirements are common in a wide range of regulatory processes, and are required by the Code of Good Regulatory Practice.

### **E.3 Issues with specificity in proposed GPS**

95. As mentioned above, the Commission is concerned about the specificity of the matters covered in the bullet points to paragraph 88 of the proposed GPS. The Commission believes such specific requirements may present difficulties during the process for amending the rules. This is because an analysis, as required by the Electricity Act, may not support rules that accord with the very specific requirements of paragraph 88.

*Anticipating the rule change process the Commission would need to follow*

96. The objective of preventing delays in investment so as to avoid jeopardising grid reliability could be pursued by setting monetary thresholds below which investments are not subject to merits review, as envisaged by the proposed amendments to the GPS. However, other reasonably practicable options exist that would need to be considered.
97. The Commission has not at this stage identified what options it would need to consider in its analysis of a proposed amendment to the Electricity Governance Rules. However, to assist in the Government's consideration of the proposed amendments, it has identified issues that are likely to affect the cost/benefit analysis of a rule change proposal and the analysis of the extent to which the objective of the proposal would be promoted or achieved by the rule change.
98. Some possible issues are:
- increasing the chance of litigation;
  - jeopardising effective scrutiny of larger investment proposals;
  - increasing the costs associated with reduction in scrutiny of investment proposals; and
  - increasing the impact of reduced scrutiny because of the aggregate value of small investments.
99. These issues are discussed below.

*Increased litigation*

100. Currently the Commission's processes provide an outlet for industry participants and other interested parties such as consumers to have their concerns about proposed grid investments taken into account by an independent body before an investment is committed to.
101. One outcome of the proposed amendment to the GPS may be that, for investments under \$20 million, industry participants and other groups could revert to litigation in order to put forward their concerns about investments.
102. Under any rule changes that may arise from the proposed amendments to the GPS, Transpower's decisions on grid investment will continue to be the exercise of a statutory power of decision, which are able to be challenged by judicial review. Judicial review, whatever the ultimate outcome, has the potential to introduce significant delays into the decision-making process for investment proposals.
103. This would be required to be factored into the Commission's analysis as working against the proposed rule change meeting the objective of expediting prudent grid investment.

*Jeopardising effective scrutiny of larger investment proposals*

104. The Commission is concerned that the proposed amendments to the GPS, aimed as they are at smaller investments in the grid, could have the unintended consequence that a much wider range of investments may not be subject to the regulatory review and approval process.
105. This concern has two aspects.
106. First, the proposed amendments may create some incentive at the margin for Transpower to disaggregate what would otherwise be considered larger investments into investments under \$20 million, avoiding the merits review that would otherwise apply.
107. A second, more significant, issue arising from the proposed amendments is that smaller investments could be undertaken, without scrutiny under the review and approval process, that could have the effect of rendering scrutiny of larger projects ineffective. This could arise, for example, if the smaller investments are preliminary to the larger investment (and would normally be considered as part of the larger investment) but, as their costs are “sunk” when the Commission considers the larger investment, the larger investment must be analysed as being more economic than alternatives that would otherwise (in the absence of the sunk costs) have been more cost-effective.
108. The Commission may have to factor this into its analysis as a cost of a proposed rule change to give effect to the GPS.

*Costs associated with reduction in scrutiny of investment proposals*

109. The Electricity Commission’s scrutiny of grid investment proposals has resulted in improvements to investments that both improve grid reliability and reduce costs to consumers and to the economy. The Commission’s analysis shows that the value added by the Commission’s oversight far outweighs the costs associated with the Commission’s role.
110. As stated earlier, the rationale for having a robust independent review of investment proposals is to address the absence of incentives on Transpower to make sound investment decisions and to provide a discipline on the planning process so that errors are detected before unnecessary costs are imposed on consumers.
111. In relation to investments valued at under \$20 million covered by the proposed amendments to the GPS, the same issues (relating to levels of reliability and avoiding significant unjustified costs) arise such that, over time, reducing scrutiny of those investments creates a risk of investments being made for which there would not be the same level of confidence.

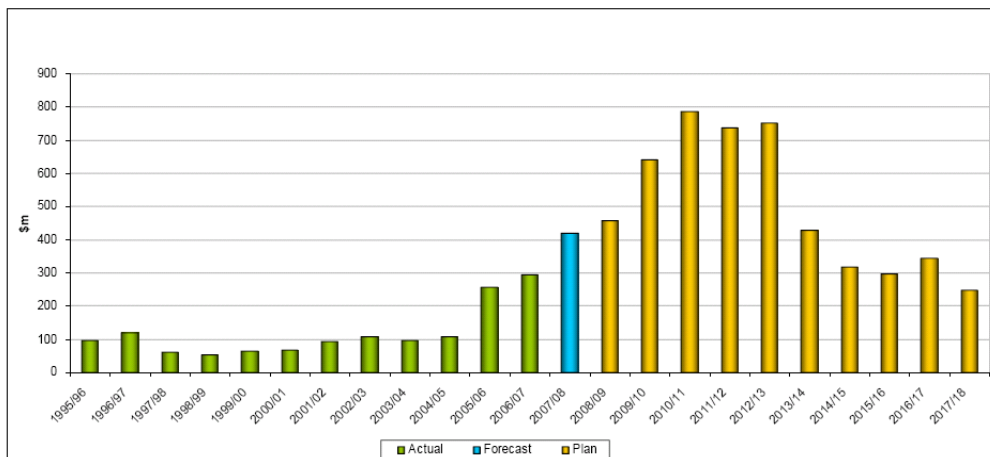
112. This reduction of the scrutiny applied to the relevant investments would be required to be factored in to the Commission’s analysis of a proposed rule change as a cost of the proposal.

*Aggregate value of small investments increases impact of reduced scrutiny*

113. The Commission understands from a press report that Transpower has 233 investment projects planned over the next five years, each valued at \$1.5 – 20 million.

114. While the value of individual projects will be lower than previously reviewed by the Commission, the total amount of investment will remain at significant levels according to forecasts of capital expenditure indicated by Transpower in recent publications, as shown in the following graph.

**\$3 to 5 billion capex over the next 10 years to meet growing demand**



Source: Presentation by Transpower to Federated Farmers National Council (18 November 2008)

115. Therefore, the risks of unjustified spending and errors in the planning process are compounded by the fact that a large number of investments with a significant combined value would be involved. This emphasises the magnitude of the costs identified in the previous section.

## **F. RECOMMENDATION ON HOW TO AMEND GPS TO ADDRESS PERCEIVED PROBLEM**

116. The Commission reiterates its support for the Government's objective that it is imperative that the electricity system must be secure and reliable, and that it must deliver energy to consumers at a reasonable price. It shares the Government's view that the grid planning, regulatory review and approval process should not jeopardise the reliability of the grid.
117. The Commission considers it is timely for the Government to seek assurance that the regulatory review and approval process is supporting grid reliability. In this way, the Commission supports the objective underlying the proposed GPS.
118. However, the Commission considers, for the reasons set out above, that the specificity of the matters in paragraph 88 of the proposed GPS means there is a significant risk that the proposed amendments will be frustrated by the requirements of the rule change processes in the Electricity Act.
119. The Commission therefore submits that the Government should consider setting the proposed amendments at a higher level, aimed at the objective to be pursued rather than at the means by which it should be pursued.
120. This would allow the processes in the Electricity Act, particularly consideration of all reasonably practicable options and consultation with substantially affected parties, to work to produce the best outcome, and one that enjoys the most support of those affected.

### *Suggested changes to paragraph 87 of the proposed GPS*

121. The Commission considers the proposed paragraph 87 is appropriate.
122. However, it suggests that the word "maintenance" be omitted from the paragraph, as grid maintenance expenditure is authorised by the Commerce Commission and so is not appropriate in a GPS directed principally at the Electricity Commission.

### *Suggested changes to paragraph 88 of the proposed GPS*

123. The Commission considers that the proposed paragraph 88 should be amended to provide the Commission with an objective to achieve, rather than setting out specific means as to how it should be achieved.
124. The Commission suggests the following wording:

*The Government expects the Commission to review section III of part F of the Electricity Governance Rules and its own procedures to meet the objective expressed in paragraph 87, and to report to the Minister by 31 July 2009 on whether it recommends any changes be made to the rules and/or its procedures.*

## **G. REMOVE UNNECESSARY DETAIL FROM GPS**

125. Finally, the Commission supports the removal from the GPS of any matters providing unnecessary detail.
126. In line with this, the Commission supports the proposal to remove paragraph 7 from the GPS. Paragraph 7 requires the Commission to make extensive use of advisory groups wherever possible to develop industry arrangements and make recommendations concerning regulations and rules.
127. Although the Commission considers such detail is not appropriate in the GPS, it nonetheless regards advisory groups as an important part of the governance arrangements for the industry, and remains committed to using advisory groups. The Commission recently undertook a review of the role and value of advisory groups. The conclusion of that review is that the groups bring a wealth of expertise to the consideration of issues that affect the industry and, because of their representative nature, help to ensure industry support for governance arrangements as they develop.
128. Other examples of unnecessary detail in the GPS are provisions about the discount rate and wind integration. The Commission considers these issues are important, but their inclusion in the GPS is unnecessary.
129. It may be that there will be a point in the future when it is suitable for the Government to undertake a more comprehensive review of the GPS, at which time it can determine what further detail could be removed from the GPS. The Commission would welcome assisting in such a review.